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In the Supreme Court of the United States

OCTOBER TERM, 1978

NO. 78-1891

WILLIAM LATTIMORE, NORMAN W. FRIES, IRVIN MAZO, MARVIN I. ROSENZWEIG, ERWIN A. FRIEDMAN GEORGE MOORE, AND BARNEY SADLER,
Petitioners

VS.

UNITED STATES OF AMERICA,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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IN THE SUPREME COURT OF THE UNITED STATES

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NO

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WILLIAM LATTIMORE, NORMAN W. FRIES, IRWIN MAZO, MARVIN I. ROSENZWEIG, ERWIN A. FRIEDMAN, BARNEY L. SADLER and GEORGE MOORE respectfully pray that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on March 23, 1979.

OPINIONS BELOW

The opinion of the United States District Court for the Southern District of Georgia is reported as Irwin Mazo, Marvin I. Rosenzweig, Erwin A. Friedman and Barney L. Sadler, Plaintiffs versus United States of America, Defendant versus Marvin I. Rosenzweig, Erwin A. Friedman, Barney L. Sadler,

William Lattimore, Norman W. Fries, George Moore, and Irwin Mazo defendants on counter-claim Civil Action Numbers 474-243, 474-244, 474-245, 474-246, which is unreported.

The opinion of the Court of Appeals for the Fifth Circuit is set out in 591 F. 2d. 1151 (5th Cir., 1979). Both opinions are set forth in the appendix hereto as is the order denying the petition for rehearing which is unreported.

JURISDICTION

The Judgment of the Court of Appeals for the Fifth Circuit was entered on March 23, 1979 and this petition for Writ of Certiorari was filed within ninety days of that date. The jurisdiction of this court is invoked under 28 U.S.C. Section 1254.

QUESTIONS PRESENTED

Section 6672 of the Internal Revenue Code imposes a penalty upon any person who is required to collect, truthfully account for and pay over any tax if that person willfully fails to collect, or truthfully account for and pay over such tax. The taxes involved in this case were the employment taxes under Internal Revenue Code Sections 3201 and 3401. In this case the District Court granted summary judgment to the government against the Petitioners who merely were officers and directors of a corporation and acted in the Corporation's management only in a passive capacity. In granting summary judgment the District Court, and the Court of Appeals for the Fifth Circuit in affirming, held that there was no material issue of fact as to Petitioners' willfullness in failing to collect or truthfully account for and pay over the

employment taxes. The questions presented are:

(1) Whether a corporate director and officer who does not participate in the management and financial affairs of a corporation and who lawfully delegates a duty to collect, truthfully account for and pay over employment taxes is a person responsible for an employment tax delinquency if, unknown to the official, the delegate fails to truthfully account for and pay over the employment taxes?

(2) Whether a material issue of fact as to willfull failure to account for and pay over employment taxes exists where a corporate officer - director, who has no knowledge of a delegate's failure to collect, truthfully account for and pay over employment taxes learns of the deficiency but continues business operations paying the government part of the deficiency while paying other creditors in order to enable the corporation to continue in business?

STATUTES AND FEDERAL RULE INVOLVED

The pertinent provisions of Sections 3102, 3402, 6671 and 6672 of the Internal Revenue Code of 1954, as amended, (26 U.S.C. 3102, 3402, 6671 and 6672) and Rule 56 of the Federal Rules of Civil Procedure are set forth in Appendix B.

STATEMENT OF THE CASE

Separate actions for tax refunds were instituted against the United States in the District Court for the Southern District of Georgia, Savannah Division under 28 U.S.C. § 1346 (a) (1) by four of the Petitioners who were officers and directors of Savannah Inn and Country Club, Inc. (the "Corporation"). Each of the four Petitioners sought a refund of

$100.00 paid in connection with employment tax assessments. The United States counter-claimed against each of the four for the unpaid balance for the total assessment of $78,619.71 and joined Petitioners George Moore, William Lattimore and Norman Fries as Parties in its counter-claim. The tax assessments involved employment taxes owed by the Corporation for the second and third calendar quarters of the year 1969. When the Corporation failed to pay the taxes, assessments were made against each of the Petitioners under 26 U.S.C. § 1672 of the Internal Revenue Code of 1954. (Tr. Judge's Opin, A.* 357-358)

Petitioners were directors, officers and shareholders in the Corporation. The Corporation acquired and renovated the General Oglethorpe Hotel and Golf Club. After renovation it was first opened on November 11, 1967, under the management of Hotel Corporation of America ("HCA"). The management agreement with HCA terminated a year later and the management was handled thereafter by a general manager and staff employed by the Corporation. (Tr. Judge's Opin., A. 358-359) George Moore was employed as the manager and was responsible for the operation of the facility and management of the various departments. (Friedman Dep. A. 441) Mark Lavoie was employed as Controller of the Corporation, which office involved the accounting and reporting for employment taxes. (Friedman Dep., A. 449, Moore Dep. A. 556, 558-560) The Corporation maintained a corporate bank account and a payroll account. The former required two signatures and the latter one, that one usually being the manager George Moore. Funds to meet the payroll were normally transferred from the corporate account to the

* "A" references are to separately bound Appendix filed with the United States Court of Appeals for the Fifth Circuit.

payroll account and payment of wages and other payroll expenses were paid out of the payroll account. (Moore Dep. A. 559-561)

Petitioner Lattimore originally conceived and organized the venture to renovate the hotel. But after other investors were brought in he experienced a period of some two and one-half (2 ½) years when his mental and physical condition deteriorated to a point where he was not able to render helpful advise and counsel on the project. (Lattimore Dep., A 105-108) This time included the quarters in question. Petitioner Lattimore remained as President and a Director of the Corporation, but his ownership interest decreased to some one or two per cent as others became more involved. (Friedman Dep. A. 417)

Petitioner Fries was a local businessman in the wholesale poultry business, which engaged most of his time. (Lattimore Dep., A. 142) Petitioner Fries used his position on the board as a useful way to look after his investment. Although he had signatory powers on the corporate account, he recalls signing only two checks, dates unknown, and the Government's evidence does not reveal any checks signed by Petitioner Fries. (Fries Dep., A. 156-157, 169)

Co-Defendants in the original Government's counter-claim, Erwin A. Friedman and Irwin Mazo were also directors and the Secretary and Treasurer respectively. (Lattimore Interr., A. 76) The record discloses they were quite active in the corporate affairs during the quarters in question and after the October 6, 1969 meeting with the Internal Revenue Service officials. (Fries Dep., A. 178, 182) In fact Irwin Mazo was the Corporation's accountant and prepared and filed the 1969 tax return. Erwin Friedman co-signed 13 checks after

October 6, 1969, in payment of other creditors of the Corporation, and Mazo co-signed 23. (Tr. Judge's Opin., A. 362, 370)

On October 6, 1969, the representatives of the Internal Revenue Service met with the petitioners and the other officers, directors and the manager of the Corporation. At this time, all parties were advised that the employment taxes for the first, second, and third quarters of 1969 had not been paid. Petitioners had no knowledge of this condition prior to their meeting. (Lattimore Dep., A. 123, 137; Fries Dep. A. 158, 172, 175) On October 6, 1969, the first quarter's liability was discharged with a corporation check in the amount of $22,521.14.

REASONS FOR GRANTING THE WRIT

The decision below should be reviewed because it erroneously interprets and applies the ruling of this Court in *United States v. Slodov*, 436 U.S. 238, 98 S.Ct. 778, 56 L.Ed. 2d 251. This inappropriate application creates confusion as to the proper standards for granting Summary Judgment when the willfullness of a tax payer is in question under Internal Revenue Code §6672.

(1) The *Slodov* decision was decided subsequent to the District Court's ruling, but the Appellate Court quoted the case extensively. In the *Slodov* decision, this Court announced the following rule, 436 U.S. at 245:

> "When the same individual or individuals who cause the delinquency in any tax quarter are also the 'responsible persons' at the time the Government's efforts to collect from the employer have failed, and it seeks recourse against the 'responsible employee' . . . there is no question that §6672 is applicable."

The Appellate Court in deciding this case relied on a rule of law that states that willfullness as a matter of law exists if responsible persons, with knowledge of an employment tax deficiency, make payments to other creditors. *United States v. Teel*, 529 F.2d 903, 905 (9 Cir. 1976) *Kalb v. United States*, 505 F.2d 506, 511 (2 Cir., 1974) and *Moore v. United States*, 465 F.2d 514, 516 (5 Cir., 1972) The foregoing cases hold this to be an all encompassing rule which would apply in all circumstances. In *Slodov* though, this Court has shown circumstances under which this would not be willfullness as a matter of law. There, the use of after-acquired funds did not result in a § 6672 penalty because there had been a "change of control." The "change of control" that occurred was a third person taking over the Corporation. The Appellate Court opinion would limit this Court's ruling to case cases where a third party steps in. However, *Slodov* applies to cases where employment taxes were not collected prior to taxpayer's "accession to control" *Slodov*, supra, 436 U.S. at 258-259. The Appellate Court thus ignores the fact that a change of circumstances or fact within the existing management of a corporation may constitute a "change of control." In this case Petitioners contend that a "change of control" occurred on October 6, 1969. The evidence shows that prior to that date Petitioners had no knowledge of the delinquency in the payment of employment taxes. The duty for collecting, truthfully accounting for and paying over employment taxes had been delegated to the Corporation's controller and manager. The Petitioners, in their capacities as directors and officers, merely served as broad policy makers and for

the purpose of protecting their investments. The Petitioners were not involved in the day-to-day management of the operation, and prior to October 6, 1969, there was no evidence that they knew of the delinquency or it was ever brought to their attention by any of the employees of the corporation. There is no doubt from the record that on October 6, 1969, the Petitioners learned of the delinquency. The Appellate Court acknowledged that the facts must be construed in the view most favorable to the Petitioner on the Government's Motion for Summary Judgment. *United States v. Diebold, Inc.*, 369 U.S. 654, 82 S. Ct. 993, 8 L. Ed. 2d 176 (1962), *Poller v. Columbia Broadcasting Systems, Inc.*, 368 U.S. 464, 82 S. Ct. 486 7 L.Ed. 2d 458 (1962), *BAW Manufacturing Company v. Slaks Fifth Avenue, Ltd.*, 547 F. 2d 928, 930 (5 Cir. 1977). Petitioners contend that on October 6, 1969, their responsibilities and obligations to see that the employment taxes of the Corporation were paid changed. At that time the "accession to control" occurred. Although, there was no rearrangement of any corporate offices, the change occurred because of the knowledge obtained by the Petitioners. The gaining of that knowledge altered their responsibility and obligation to see that the employment taxes were paid. Since a "change of control" occurred on October 6, 1969, before the above quoted language from the *Slodov* decision can be applicable to the Petitioners, the Government must show that the Petitioners in some fashion caused the delinquency. The District Court and the Appellate Court did not address the issue of whether Petitioner caused the delinquency. The District Court acknowledged that there possibly may be an issue of fact as to whether the Petitioners were responsible parties prior to the October 6, 1969 meeting. On the other hand, the Appellate Court says that the fact of Petitioners' lack of knowledge as to the delinquency as material or immaterial is resoluble on summary judg-

ment. In light of the evidence and the presumptions on Summary Judgment, it appears that the Appellate Court felt that the District Court need not decide on Petitioners' role in causing the delinquency. The Appellate Court Opinion justifies its failure to address the knowledge issue by refering to the Petitioners' status, duty, and authority. The mere fact of holding a corporate office does not, in and of itself, render a person responsible for collecting and paying over employment taxes. *Bauer v. United States*, 543 F. 2d 142, 149 (Ct. Clms, 1976.), *Monday v. U.S.*, 421 F.2d 1210, 1214 (7 Cir. 1970) The delegation of the duty to collect, account and pay over employment taxes to another has been held to be a defense to a charge of responsibility for causing an employment tax deficiency *U.S. v. Leushcner, Sr.*, 336 F.2d 246, 248 (9 Cir., 1964), especially when the corporation officers are without knowledge as to the deficiency, *Kalb v. U.S.*, supra, 505 F., 2d at 511. Therefore, the Appellate Court fails in its attempt to bring this case within the language of *Slodov* because it totally disregards the issue of Petitioners' status as persons who caused the delinquency and an examination of the facts prior to October 6, 1969.

Having ignored the issue of whether Petitioner caused the delinquency the Appellate Court then complicates the situation by relying on a rule of law which is inapplicable if the person did not cause the delinquency. Citing *United States v. Teel*, supra, *Kalb v. United States*, supra. and *Moore v. United States*, supra., the Appellate court states that the payment of other creditors with knowledge of an employment tax deficiency is evidence of willfullness as a matter of law. This is contrary to *Slodov* since this Court, as noted herein, specifically explained circumstances under which payments to creditors with knowledge of a deficiency will not be willfullness as a matter of law under the provisions of

Internal Revenue Code § 6672. The District Court, though, decided on the case based on this rule of law cited from *Teel*, (A. 373) On the other hand, the Appellate Court as noted ignored the question of Petitioners' knowledge and role in causing the delinquency. Since the rule announced in *Teel* has been limited in its application, the reliance on that rule by the Appellate Court without dealing with whether Petitioners caused the delinquency is contrary to the *Slodov* decision.

(2) Sacred to American law is the concept of wherever there is a question of fact to be decided by a jury, a Court should not take a case away from a jury by attempting to decide the question of fact in place of a jury. The issue of willfullness in § 6672 cases is usually factual which the Appellate Court acknowledged. (Opinion page 3704) But relying on *Teel*, supra, the Appellate Court concludes that the facts are not sufficiently controverted to preclude the granting of a Summary Judgment because the Petitioner permitted payment of other creditors after October 6, 1969.

The record though discloses other facts which were not considered on the willfullness issue. First, Petitioner Lattimore was quite ill during most of the time, suffering mental and physical ailments which limited his efforts on behalf of the corporation: (A. 106-107) Petitioner Fries was not active in the management of the Corporation and signed no checks to pay creditors after October 6, 1969. The Appellate Court ignores the fact that after the October 6, 1969 meeting the first quarter of employment taxes were paid. Although the Government cannot be made an unwilling joint venturer with a corporation, (Opinion page 3700) to ignore this fact in judging willfullness is contrary to the statement of this Court that "it is in the IRS'S interest to encourage the responsible

person to continue operation with the hope of receiving payment on the back taxes. . ." *Slodov*, supra, 56 L.Ed. 2d at 265. Since the IRS benefited from the continued operation of the Corporation after the officers and directors learned of the deficiency on October 6, 1969, this fact should have been reviewed by a jury in determining the willfullness issue. Finally, seven individuals were assessed the § 6672 penalty. It is virtually inconceivable that that many individuals could have been involved in and exercised that degree of control over corporate affairs as to be considered "responsible persons" and to have their acts considered willfull. Especially when positions as directors and officers were given to investors to reward them for their investment and as a way for them to participate and act as advisors. (Friedman Dep., A. 406, 443) Some may have been negligent, but negligence is not a ground for assessing the penalty. *Kalb v. United States*, supra, 505 F 2d at 511, *Dudley v. United States*, 428 F. 2d 1196, 1200 (9 Cir., 1970). The District Court and the Appellate Court failed to recognize an issue of fact as to which of the seven were responsible and acted willfully.

Therefore, the Appellate Court in upholding the grant of Summary Judgment in the face of these facts reveals that it is applying a willfullness rule of law discredited by the *Slodov* decision. This court must rectify this in order that the application of Summary Judgment willfullness cases ar 1 § 6672 is uniform.

By: _____

Fred S. Clark,
Attorney for William Lattimore and Norman W. Fries

By: _____
Morton G. Forbes
Attorney for George Moore

By: _____
Bruce A. Howe,
Attorney for Irwin Mazo,
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Sadler

CERTIFICATE OF SERVICE

I certify that I have served a copy of the foregoing Brief upon the following named counsel by depositing a copy of the same in the United States Mail, properly addressed, with proper postage affixed thereto.

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This 20th day of June, 1979.

_____
Fred S. Clark
For Appellants

APPENDIX A

DISTRICT COURT OPINION

IN THE UNITED STATES DISTRICT COURT FOR THE
SOUTHERN DISTRICT OF GEORGIA
SAVANNAH DIVISION

IRWIN MAZO, MARVIN I. ROSENZWEIG, ERWIN A. FRIEDMAN and BARNEY L. SADLER,

Plaintiffs

vs.

UNITED STATES OF AMERICA,

Defendant

vs.

CIVIL ACTION
NOS. 474-243
474-244
474-245
474-246

MARVIN I. ROSENZWEIG, ERWIN A. FRIEDMAN, BARNEY L. SADLER, WILLIAM LATTIMORE, NORMAN W. FRIES, GEORGE MOORE, and IRWIN MAZO,

Defendants on Counterclaim

OPINION AND ORDER ON MOTION OF UNITED STATES FOR SUMMARY JUDGMENT

Separate actions for tax refunds were instituted against the United States, under 28 U.S.C. § 1346 (a)(1), by Irwin Mazo, Marvin I. Rosenzweig, Erwin A. Friedman and Barney

L. Sadler. Each of the plaintiffs seeks a refund of $100 paid in connection with employment tax assessments. Pursuant to 28 U.S.C. § 1346(c), the United States counter-claimed against each plaintiff for the unpaid balance of the total assessment of $78,619.71. In addition to the four plaintiffs referred to, the Government has joined William Lattimore, Norman W. Fries and George Moore as parties to its counter-claims. The four separate actions by Mazo, Rosenzweig, Friedman and Sadler were consolidated.

The tax assessments involve withholding taxes owed by Savannah Inn and Country Club, Inc. for the second and third calendar quarters of the year 1969. When the corporation failed to pay the taxes, assessments were made against each of the individual parties in this litigation under 26 U.S.C. § 6672 of the Internal Revenue Code of 1954. The Government claims that they are "responsible persons" who willfully failed to collect, truthfully account for, and pay over withholding and social security taxes in the amount of $78,719.71.

Both the Government and the taxpayers have moved for summary judgment. The motions were orally argued and briefs have been filed. The record before the Court on the motions consists of the pleadings, depositions, affidavits and exhibits.

The questions presented by the record are (1) whether, as a matter of law, the taxpayers were "responsible persons" in respect to collecting and paying over to the United States withheld income and Federal Insurance Contributions Act taxes collected from the employees of Savannah Inn and Country Club, Inc. in the second and third quarters of 1969 and (2) whether such failure to pay the employment taxes

amounted to willful conduct on the part of the taxpayers.

I

THE FACTUAL BACKGROUND

In 1965 William Lattimore entered into a contract with the trustees of the Central State, the Southeast, and Southwest Areas Pension Fund for the acquisition of the property known as the General Oglethorpe Hotel and Golf Club. Mr. Lattimore intended to renovate the Hotel and the golf course and convert the property into a national resort. From the outset financial difficulties arose with respect to permanent mortgage financing. It was eventually decided to bring a group of investors into the venture. As a result of such decision, the individual parties in this case (other than Mr. Moore) became stockholders as well as officers and members of the Board of Directors of Savannah Inn and Country Club, Inc.

Notwithstanding the capital initially invested by the local investors, financial difficulties continued to beset the corporation.[1] Several supplemental financing arrangements were entered into including additional equity investments by the stockholders, borrowings from the holder of the first mortgage, bank loans, and a loan from the Small Business Administration.

The renovation of the facility was completed during the latter part of 1967. Sometime prior thereto, the corporation

1. The original financing of the venture included $300,000 from local investors; $100,000 from Incentive Capital Corporation; $150,000 from Liberty National Bank & Trust Company and $1,050,000 from the Teamsters' Pension Fund.

had entered into management and investment agreements with Hotel Corporation of America (HCA) under which the latter made a substantial capital investment in the venture in return for an interest therein. A long term management contract was entered into with HCA.

The facility was opened on November 11, 1967. The arrangement with HCA was terminated by mutual agreement in November, 1968. The management of the facility was handled thereafter by a general manager and staff employed by Savannah Inn and Country Club, Inc. George Moore was employed as manager. The Company continued to operate the hotel and golf course until February, 1970. At that time the holder of the first mortgage foreclosed on the sole asset belonging to Savannah Inn and Country Club, Inc. Since the foreclosure, the corporation has been completely dormant. It is insolvent.

II

RESPONSIBILITY FOR COLLECTING AND PAYING WITHHELD TAXES

An employer is required to withhold income taxes and the employee's share of Federal Insurance Contributions Act taxes from wages paid. 26 U.S.C. § 3102(a). Taxes withheld from earnings are held in trust for the Government by the employer under Sec. 7501(a) of the Internal Revenue Code of 1954.[2] The withheld taxes must be paid to the United States at quarterly intervals. See 26 C.F.R. §31.6071(a)-1.

2. "Once withholding and FICA taxes are collected they become a trust fund in the hands of the employer." *In Re Goodson Steel Corporation,* 488 F.2d 776 (5th Cir.).

The amounts required to be deducted by an employer from an employee's wages represent current payments of the employee's federal income tax and his portion of the social security tax. The taxes so deducted are credited by the employee against his personal tax liability when he files his annual income tax return. This is true regardless of whether the withheld taxes are properly paid over to the United States or are used by the employer for payment of debts to non-preferred creditors. If the withholding taxes are not collected by the United States from the employer or personally from its officers or persons found liable under Section 6672, such tax is lost. *Dillard v. Patterson,* 326 F.2d 302, 304 (5th Cir.).

To assure collection of these amounts, Congress enacted Sections 6671 and 6672 of the Internal Revenue Code of 1954. The practical effect of the statute is to impose upon the "responsible persons" of a defaulting employer a separate tax equivalent in amount to misappropriated trust funds due the United States and which, with the knowledge of such responsible persons, is not paid.

The elements necessary for imposition of the penalty under Section 6672 are twofold. The person or persons against whom the equivalent tax is assessed must have had the authority to direct or control the payment of corporate funds. *Wilson v. United States,* 250 F.2d 312, 316 (9th Cir.); *Liddon v. United States,* 448 F.2d 509 (5th Cir.). Secondly, once it is determined that a person possesses such authority, it must be decided whether or not such individual's failure to see to it that the sums due were paid was "willful."

Section 6671(b) thus defines "person" in Section 6672:

> "The term 'person', as used in this subchapter, includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee or member, is under a duty to perform the act in respect of which the violation occurs."

Section 6672 is liberally construed in order to effectuate its intended purpose of collection from responsible persons of employment taxes withheld by the taxpayer but not turned over to the United States. See *Moore v. United, States, supra,* 465 F.2d 518. "Responsible persons" is a broad term, including any person who is connected or associated with the corporation-employer in such a manner that he has the power to see that the taxes are paid, to make final decisions concerning the corporation, or to determine which creditors are to be paid and when. The term may include corporate officers, employees, members of the board of directors and stockholders. See *Liddon v. United States, supra,* 448 F.2d 512-13.

As stated in *Moore v. United States*, 465 F.2d 514, 518 (5th Cir.):

> "Section 6672 has not been strictly construed as is the usual rule with penalty statutes, but has been broadly and liberally construed to fulfill the purposes for which it was intended, particularly in determining who are 'responsible persons' within the coverage of the statute."

Defendants Mazo, Friedman, Rosenzweig, Fries, Lattimore, and Sadler were each an officer, a member of the board of directors and shareholder of the Savannah Inn and

Country Club, Inc. They admitted in their depositions that two signatures were necessary to negotiate any and all checks drawn on the operating account of the Savannah Inn and Country Club, Inc., and that they were authorized signatories. Each of them as members of the Board of Directors was empowered to authorize new signatories for the bank account of Savannah Inn and Country Club, Inc. All of the individuals had invested substantial sums of money in the corporation.

Mr. Mazo admitted that he prepared and filed the income tax return for the corporation for the year 1969. He stated that after being notified by the Internal Revenue Service that the taxes were due, he told the Service that he would make certain that the taxes would be properly paid.

Mr. Friedman conceded that the entire Board of Directors was responsible for making the payments for the first quarter taxes for the corporation. The first quarter liability was paid by check drawn on the corporation's account and signed by Mazo and Friedman. According to the latter, the Board had the power to fire anyone in the corporation.

Mr. Rosenzweig admitted using his signature on the corporate checking account as a control device over the finances of the Savannah Inn and Country Club.

Mr. Sadler testified that he would look at the checks before signing them to see if they were payable to a vendor before he would sign same. He said that he would not sign a check made payable to anyone else.

Mr. Lattimore had been the President of the corporation since its organization. He admitted in his deposition that the

responsibility for management and ultimate decision-making in the corporation reposed in the officers and the Board of Directors. He further stated that the managerial, administrative and control functions of the corporation shifted within the group of investors as their respective individual investments increased.

Mr. Fries testified that the financial problems of the corporation were frequently discussed at meetings of the Board as well as the dollar amount owed various creditors.

George Moore was not a member of the Board of Directors, shareholder or corporate officer of Savannah Inn and Country Club, Inc. As general manager, he was responsible for the operation of the Inn and the management of its various departments. He testified that he had the authority to sign checks in conjunction with one of the directors but that he did not have the final say as to what bills should or should not be paid. Mr. Moore stated that the department heads reported directly to him and that he in turn reported to the Board of Directors. He admitted that he was involved in the administrative functions of the Savannah Inn and Country Club, Inc. in its day-to-day activities. Mr. Moore testified that he possessed the authority to request that certain creditors be paid. He attended meetings of the Board. His annual salary was $25,000.

The Government contends that the defendants, by their admissions were, as a matter of law, responsible persons under Section 6672. The taxpayers contend that they occupied a completely passive position with respect to management of the business of the corporation. Although they assumed the traditional role of establishing management policy for the operation, none of them participated in any

way in the day-to-day operation of the corporate affairs. At no time, they say, was any of them an employee of the Inn.

It is the position of the defendant-taxpayers that although they possessed the authority to countersign checks drawn by the corporation, it was a mere formality -- an "accomodation", according to some of them. They contend that they were in no way involved in collecting or reporting the withholding and FICA taxes. The taxpayers insist that their sole function was to counter-sign the checks and that all accounting and reporting in connection with the payroll and employment taxes was the responsibility of Mark Lavoie as controller of the Company. [3]

The Savannah Inn and Country Club maintained two checking accounts. There was a general or operating account in which all corporate deposits were placed. For the purpose of paying wages, withdrawals therefrom were made and deposited in a special payroll account from which distributions to the individual employees were made by separate checks drawn on the payroll account. The withholding taxes collected from employees remained in the operating account. The employer maintained no special account for the deposit of collected withholding taxes. Such deductions constitute, as

3. Under the Bank's data processing system, the printed signature of the general manager, George Moore, was already on the checks. The taxpayers attach to their motion for summary judgment a statement of Mr. Lavoie dated October 9, 1969, in which he said that he was responsible for paying withheld federal taxes. Such is the taxpayers' version of the statement. The record includes (Government Exhibit #26) an IRS interview statement signed by Mr. Lavoie on March 4, 1970. He said he was ware that in April, 1969 the taxes were not paid and that there was a meeting with the officers at which the subject was discussed. Asked who was responsible for paying withheld federal taxes, he replied, "general manager of officers." Lavoie stated that the reason the taxes were not paid to the Government was that the collected funds were used to pay other corporate obligations. The parties responsible for paying such other obligations was "the management."

already noted, a "special fund in trust for the United States." 26 U.S.C. §7501(a).

The procedure adopted by the Company resulted in commingling trust monies with corporate funds and the indiscriminate use thereof in paying corporate obligations at the expense of the taxes held for the Government. Apparently no effort was made by any of the officers and directors of a failing business to determine whether monies held in trust were being used to pay creditors other than the United States.

The officers and directors of the Company point accusing fingers at Lavoie, contending that he (and Mr. Moore) are the only ones who can be faulted. Both were employees. Lavoie's annual salary as controller was $12,000 per year. The brief of Messrs. Mazo, Rosenzweig, Friedman and Sadler asserts that Lavoie concealed from them the fact of the failure to withhold and report the taxes and that he was "covering up his actions" as late as October 6, 1969. They further contend that he informed Moore that the Bank had checks sufficient to cover the taxes.

The mere fact that a person is not a disbursing officer and has no authority to draw or sign checks is too narrow a construction of § 6672. The pertinent question is whether the board of directors had the final word as to what bills should or should not be paid and when. *United States v. Graham*, 309 F.2d 210, 212 (9th Cir.). More than one officer of a corporation may be liable for failure to pay federal withholding and employment taxes. *Datloff v. United States*, 252 F. Supp. 11, 33 (E.D., Pa.), affirmed 370 F.2d 655 (3rd Cir.); *Monday v. United States*, 421 F.2d 1211, 1214 (7th Cir.), cert. den. 400 U.S. 821.

Under the corporation's By-Laws, "The Board of Directors shall have the control and general management of the affairs and business of the Company." The Government argues that the Directors had the ultimate responsibility as to the control and use of the corporate funds, including payment of withholding taxes since checks could not be issued to creditors without their authorization by counter-signature.

All the taxpayers testify that they were unaware that the taxes had not been paid until October 6, 1969. On that date they were informed of such fact at a meeting with representatives of the Internal Revenue Service.

Of the total withholding and FICA taxes owed to the Government in October the amount of $49,386.04 represented monies collected and withheld during the second quarter and $29,333.67 collected during the third quarter which ended September 30, 1969. The taxpayers apparently contend that even if they were responsible persons under the statute, they could not have acted willfully in failing to pay over the collected funds as they were unaware of nonpayment until after the two quarters in question had expired.

A question of fact possibly exists as to which of the taxpayers were responsible persons (certainly *some* of them were) from April 1, 1969 to October 6th of that year. The duty to see that collected taxes are remitted to the Government resides "in high corporate officials charged with general control over corporate business affairs who participate in discussions concerning payment of creditors and disbursal of funds." Certainly such officials are charged with the duty to collect, account for and pay over collected withholding taxes after they are informed that same are overdue. *Monday v.*

United States, supra, 421 F.2d 1214-1215.

In the present case knowledge of the taxpayers as to nonpayment bears both on the question of responsibility and that of willful conduct. I will defer the issue of whether such defendants or which of them were responsible persons and will deal with it hereafter in this Opinion.

III

WILLFULNESS UNDER THE STATUTE

No criminal intent or evil motive is necessary to meet the demands of the civil definition of "willful" in Section 6672 of the Internal Revenue Code. *Dillars v. Patterson,* 326 F.2d 302 (5th Cir.); *Frazier v. United States,* 304 F.2d 528 (5th Cir.); *Bloom v. United States,* 272 F.2d 215 (9th Cir.), cert. denied 363 U.S. 803. Conduct has been held to have been willful where a responsible officer or person makes a voluntary, conscious and intentional choice to pay creditors other than the United States. *Dillars v. Patterson, supra,* 326 F.2d 304. "An act is willful if it is voluntary, conscious, and intentional. If you find that plaintiff and/or third-party defendant knowingly used available funds to prefer other creditors over the United States, then you must find that he acted willfully." This was the instruction to the jury approved by the litigants in *Monday, supra,* 421 F.2d 1216. See also *McCarty v. United States,* 437 F.2d 961-968-69 (Ct. Claims).

In *Newsome v. United States,* 431 F.2d 742 the Court of Appeals for the Fifth Circuit held that liability under Section 6672 can be premised upon the use of the withheld funds for corporate purposes other than the payment of employment taxes before the date the corporation is required

to pay over the funds. Referred to as the "risk" theory of willfulness, it is thus described by the Fifth Circuit:

> "The responsible officer's actions before the due date for payment of the withheld taxes satisfies the 'willful' requirement under Section 6672; when the responsible officer . . . knows that the withheld funds are being used for other corporate purposes, regardless of his expectation that sufficient funds will be on hand on the due date for payment over to the government. Of course, the officer is only liable under Section 6672 if the corporation does not pay over the withheld taxes at the date prescribed in the regulations. However, he subjects himself to liability under 6672 when he voluntarily and consciously 'risks' the withheld taxesin the operation of the corporation, and subsequently the corporation is unable to remit the withheld taxes."

At p. 746.

A responsible person acts willfully if he acts with a reckless disregard as to whether or not the withheld taxes will be remitted to the United States. *Monday v. United States, supra,* 421 F.2d 1210. In *Teel v. United States,* 529 F.2d 903, 905 the Ninth Circuit noted that:

> "The court [in *Kalb v. United States,* 529 F.2d 903, 905 (2nd Cir.)] rejected an argument that even lack of knowledge of nonpayment rendered the nonpayment willful because of a duty on the part of any responsible person to investigate to see that the payments were being made. The court

> instead held that for nonpayment to be willful there must be either knowledge of nonpayment or reckless disregard of whether payments were being made. We find the reasoning of the *Kalb* court to be persuasive and hold that if the appellants could prove nonreckless ignorance of the failure to pay over, until the date of receivership, then no penalty under 26 U.S.C. §6672 could attach."

Willful conduct includes a failure to investigate or to correct mismanagement after notice that withholding taxes have not been remitted to the Government. *United States v. Leuschner*, 336 F.2d 246 (9th Cir.); *Dougherty v. United States*, 327 F.Supp. 202 (D.S.D.), aff'd without opinion, 471 F.2d 656 (8th Cir.); *Burack v. United States*, 461 F.2d 1282, 198 Ct. Cl. 855.

In *Goebert v. United States*, 412 F.Supp. 356, 361 (E.D., Pa.) the district court stated in its findings of fact:

> "Plaintiff claims he has not acted willfully, because he did not actually know that withholding taxes were due. Of course, if plaintiff actually knew that withholding taxes were due to the government at a time when he withdrew funds from the corporation to pay GBIC, then plaintiff would have acted 'willfully' as defined above."

The district court found in *Goebert* that the fact that plaintiff caused payments to be made constituted, under the circumstances, willfulness in that his acts were committed with a reckless disregard for obvious or known risks. Quoting an observation made in a similar case by the Fifth Circuit, the Court added: "We need not condone a game of

blind mans buff in avoidance of a statutory duty." See *Gefen v. United States*, 400 F.2d 476, 483 (5th Cir.).

IV

WILLFULNESS IN THE LIGHT OF THE RECORD

The Government moves for summary judgment on the theory that as a matter of law the conduct of the taxpayers in respect to the use of the collected withholding and employment taxes was willful. "As a general proposition, summary judgment is likely to be inappropriate when issues of motive, intent and other subjective feelings and reactions are material." 6 *Moore's Federal Practice* § 56-17 [41. - 1], p. 59-930; *Alabama Great Southern Railroad Company v. Louisville and Nashville Railroad Company*, 224 F 2d 1, 5 (5th Cir.). The matter of state of mind frequently presents a subjective issue of fact but not here.

I referred, earlier in this Opinion, to the meeting of the taxpayers with the I.R.S. representatives on October 6, 1969. All of the defendants were present at the conference. Its purpose was to inform them of the fact that the taxes collected for the first,[1] second and third quarters had not been remitted.

Whatever the status of the taxpayers as responsible persons may have been prior to October 6th, they were in that category after that date. Their responsibility to see that payment was made to the Government of collected withholding taxes did not merely apply to future collection and remittance.

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4. The first quarter liability was discharged by the corporation in October, 1969.

The fact that there may have been no willful conduct prior to October 6th did not relieve the taxpayers of their obligations as responsible persons after that date in respect to taxes collected for the second and third quarter.

After October 6th the use of corporate funds to pay and prefer other creditors than the United States constituted, as a matter of law, a willful violation of law, rendering the officers and directors liable for the penalty imposed. See *Goebert v. United States, supra*, 412 F. Supp. 361.

By counter-signing checks after October 6, 1969, each of the taxpayers preferred at least one creditor over the claim of the United States. The record before this Court shows the following in respect to payments to other creditors than the Government after October 6, 1969.

Mr. Friedman was an officer, director and shareholder of Savannah Inn and Country Club. He signed thirteen checks drawn on the corporate account between October 15 and 29, 1969, each representing an obligation of the Inn. They totalled $5,190.34 of which $2,097.26 was paid to an advertising firm.

Mr. Fries was an officer, director and stockholder. In October, 1969, checks were signed by Mr. Moore and drawn on the Manager's Special Account. A total of $1,520.08 thereof represented payments of debts owed by the corporation to Mr. Fries' poultry business. His total investment in the business was from $125,000 to $160,000.

Mr. Mazo was an officer, member of the Board and a stockholder. A certified public accountant, he prepared the income tax return for the corporation for the year 1969.

Between October 15 and 22, 1969, Mr. Mazo counter-signed twenty-three checks on the operating account, totalling $23,552.42, all of which were in payment of debts of the corporation, including sizeable obligations to the Bank and to another creditor. His total investment in the Company was approximately $250,000.

In addition to his counter-signature on the regular or operating checking account of the Inn, George Moore signed, as General Manager during November, 1969, checks drawn by him on the Manager's Special Account. He preferred at least one hundred and thirty-two creditors in the total dollar amount of $20,809.47. All of these checks were drawn after the meeting with the I.R.S. representatives on October 6th.

Mr. Lattimore was the moving force in planning the Hotel project. From the time of its organization he served as President of the corporation and was a member of the Board. Between October 7 and October 31, 1969, Mr. Lattimore counter-signed checks totalling $5,005.58. They represented payment to some fifteen creditors who were preferred over the United States. As late as December 9, 1969, he counter-signed a check in the amount of $2,611.86. The checks represented various obligations of the corporation and also sizeable withdrawals for petty cash for apparent use by the manager in paying current obligations of the Inn.

Mr. Rosenzweig was an officer, director and stockholder of Savannah Inn and Country Club, Inc. His investment in the enterprise amounted to between $175,000 and $200,000. He acknowledged that he used his signature on the corporate checking account as a control device over the Company's finances. Mr. Rosenzweig testified in connection with his weekly counter-signing of checks that "we would pay what-

ever bills we were going to pay." Between October 6 and October 9, 1969, he co-signed six checks payable to creditors other than the United States, totalling $6,905.78. Two of them, one for $3,000 and one for $500 were payable to himself. The debt was apparently owed to his market business. Mr. Rosenzweig put $55,000 into the business after December 23, 1969, in order to keep the hotel open. At that time the second and third quarter withholding and FICA taxes were unpaid. No part of his additional investment was used to pay such taxes.

Mr. Sadler was an officer, member of the board of directors and a shareholder in the Company. After the meeting on October 6, 1969, and despite his knowledge that the federal taxes were being unpaid (it "upset" him), he, like the others, took no action to see that the past due taxes were paid before other creditors were satisfied. Mr. Sadler's investment amounted to over $100,000. He admitted that he used the two signature requirement as a control device. It was Sadler's practice to look at the check to see if it was payable to a vendor before he would sign it.

During the second and third quarters the corporation maintained bank balances and had sufficient funds on deposit to pay the taxes in dispute. During the month of October, 1969, the total deposits made in the corporate checking account amounted to $98,869.69.[5]

One may well wonder and speculate as to what happened. Why was a decision reached to use taxes collected in trust for the Government in the operation of the Inn during October,

5. As late as December, 1969, at least $19,479.75 was deposited in the corporate checking account but was not used to pay the outstanding taxes.

1969? Obviously, necessity was placed above both moral and temporal law. The venture was clearly failing. The corporation had no working capital other than what the investors from time to time added to their original investment. Apparently, it was hoped against hope that the business situation would improve and a deliberate choice was made not to turn over to the Government the withholding taxes collected in the third quarter.

At that period there was at least a prospect of a sale of the Hotel. It was to the interest of the investors to sell the business as a going concern. On October 27, 1969, one of the owners wrote a letter detailing what had been done in the direction of selling the property. "I feel we have made substantial progress in locating a number of parties who have expressed a genuine interest in acquiring the Savannah Inn facilities." Government Exhibit #20. Another investor testified that they were "trying to hold this giant together to see if we could find someone that wanted to operate it that had the capital and so forth to bail us out." Rosenzweig dep., p. 15.

It is, of course, immaterial whether the responsible persons believe that the use of the collected federal taxes to pay other corporate creditors is necessary to keep a business afloat. Whatever their belief may have been that the corporation would ultimately be in position to pay the Government, those responsible for taking the risk act at their peril. *Newsome v. United States, supra,* 431 F.2d 746. A voluntary and intentional choice was necessarily made here by the taxpayers to use or permit the use of trust monies to pay creditors of the corporation other than the Government. See *Dillard v. Patterson, supra,* 326 F.2d 304-305.

In *Teel v. United States, supra,* 529 F.2d 905-906 the Ninth Circuit said:

> "[I]t is uncontroverted that after October 17, 1966, the appellants knew that there had been arrearages in the payments of income and social security tax in the previous quarter and they continued not to pay the arrearages or the tax they withheld during October and November of 1966... So after October 17, 1966, they used funds received from the sale of old inventories and the sale of new merchandise to pay cash for more new merchandise. The agreement seems sensible and honest. But the trouble is that as the cash went into the cash drawer, it became subject to trust or lien in favor of the federal government for the unpaid withholding taxes. By dissipating the cash for new purchases, of which the taxpayers knew, they unwittingly supplied the necessary willfulness. Because the failure to pay the arrearages and current tax after October 17, 1966, was willful, any factual issue as to ignorance of nonpayment prior to October 17, 1966, is not material."

The hoedown is over. The time has come to pay the fiddler.

ORDER

Finding no genuine issue of fact that the taxpayers concertedly and deliberately preferred corporate creditors other than the United States after actual knowledge by them that the withholding taxes collected by the employer for the second and third quarters were used for operating expenses

and were unpaid and

Concluding that the taxpayers were "responsible persons" and that their actions or non-actions constituted willful conduct subjecting them as individuals to the penalty provided for in 28 U.S.C. § 6672,

It is Ordered and Adjudged as follows:

1. The motion for summary judgment filed by the United States is granted.

2. The motions of the taxpayers for summary judgment are overruled.

3. Judgment will be entered in favor of the United States against the defendant taxpayers, jointly and severally, in the principal amount of $78,619.71 (less credits) together with costs, and with interest thereon from the dates of the assessments at the annual rate as prescribed by and computed under the pertinent statute and regulations.[6]

This March 22nd, 1977.

s/ Alexander A. Lawrence
JUDGE, UNITED STATES DISTRICT COURT - SOUTHERN DISTRICT OF GEORGIA

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6. See 34 Am. Jur. 2d Federal Taxation § 9350.

FIFTH CIRCUIT OPINION

CORRECTED

Irwin MAZO, Marvin I. Rosenzweig, Erwin A. Friedman and Barney L. Sadler, Plaintiffs,

v.

UNITED STATES of America, Defendant-Appellee,

v.

Marvin I. ROSENZWEIG, Erwin A. Friedman, Barney L. Sadler, William Lattimore, Norman W. Fries, George Moore, and Irwin Mazo, Defendants-Appellants.

No. 77-2104.

United States Court of Appeals, Fifth Circuit

March 23, 1979.

Officers, directors, stockholders, and the general manager of a corporation appealed from a judgment of the United States District Court for the Southern District of Georgia, Alexander A. Lawrence, J., holding them liable for the penalty assessable upon a corporation's failure to pay over employment taxes to the Government. The Court of Appeals, Alvin B. Rubin, Circuit Judge, held that where the responsible

persons had knowledge of payments to other creditors after they were aware of the failure of the company to pay over the taxes withheld, their actions were "willful" and they could be held personally liable.

Affirmed.

1. Internal Revenue 1766.3

Where there has been no change in corporate control, responsible persons are subject to duty to apply any available unencumbered funds to reduction of accrued withholding tax liability, whether or not those funds are deemed to be trust funds within meaning of statute. 26 U.S.C.A. (I.R.C. 1954) § § 6672.7501.

2. Internal Revenue 2341

Under statute providing that officer or employee of corporation who is responsible for collection of employment taxes may be assessed penalty if he willfully fails to account for and pay over amount due to the United States, "willfulness" requirement is satisfied if responsible person acts with reckless disregard of known or obvious risk that trust funds may not be remitted to Government, such as by failing to investigate or to correct mismanagement after being notified that withholding taxes have not been duly remitted. 26 U.S.C.A. (I.R.C. 1954) § 6672.

See publication Words and Phrases for other judicial constructions and definitions.

3. Internal Revenue 2341

Reasonable cause may excuse responsible persons' failure

to collect, account for, or pay over withholding taxes, but mere delegation of responsibility to another does not constitute reasonable cause. 26 U.S.C.A. (I.R.C. 1954) § 6672.

4. Internal Revenue 2368.1

Under statute providing that officer or employee of corporation who is responsible for collection of employment taxes may be assessed penalty if he willfully fails to account for and pay over amount due to United States, once assessment of penalty taxes is made and it is established that taxpayer is responsible person, burden of proving lack of willfulness is on taxpayer. 26 U.S.C.A. (I.R.C. 1954) § 6672.

5. Internal Revenue 2341

Where responsible persons had knowledge of payments to other creditors after they were aware of corporation's failure to pay withholding tax due Government, requirement of "willfulness" was satisfied and responsible persons could be held personally liable for penalty. 26 U.S.C.A. (I.R.C. 1954) § 6672.

Appeals from the United States District Court for the Southern District of Georgia.

Before GEWIN, GEE and RUBIN, Circuit Judges.

ALVIN B. RUBIN, Circuit Judge:

An officer or employee of a corporation who is responsible for the collection of employment taxes from the pay due an

employee may be assessed a penalty equal to the amount of the taxes if he willfully fails to account for and pay over the amount due to the United States. 26 U.S.C. § 6672. The government found such liability on the part of those parties who were simultaneously the officers, directors and stockholders of Savannah Inn & Country Club, Inc., and its general manager, George Moore. Although each of them protests that he had a title and position without genuine authority, each was, under the statute, a responsible person both at the time tax was withheld and at the later date when funds were available to pay it and were diverted to other purposes, and within the meaning of the statute the failure of each to perform his duty was willful; to paraphrase an amphorism of the late President Harry Truman, the corporate buck stopped with them. Accordingly, we affirm the judgment of the trial court granting the motion for summary judgment filed by the United States and denying the motion for summary judgment filed by the officers.

I.

Under the withholding system set up in the Internal Revenue Code, 26 U.S.C.A. § 3401 *et seq.*, employers have a duty to collect both income and FICA ("social security") taxes from their employees. These sums are commonly referred to as "trust funds" because the Code provides that they are deemed to be "a special fund [held] in trust for the United States." 26 U.S.C. § 7501. When net wages are paid to the employee, the taxes that were, or should have been, withheld are credited to the employee even if they are never remitted to the government; so the IRS has recourse only against the employer for their payment.

However, Section 6672 of the Internal Revenue Code im-

poses a penalty on any "person required to collect, truthfully account for, and pay over any tax" withheld who willfully fails to do so. The penalty is equal to the total amount of the tax not paid over, and is itself referred to as a "tax" in Section 6671. The term "person," as defined in Section 6671, includes "an officer or employee of a corporation . . . who as such officer [or] employee. . . is under a duty" to collect, account for, and pay over the withheld tax. This is known as a "responsible person." Thus, liability for a penalty is imposed only on (1) a responsible person (as defined in Section 6671), who has (2) willfully failed to perform a duty to collect, account, "and" pay over the tax.

The statute has recently been explained by the Supreme Court in *Slodov v. United States*, 1978, 436 U.S. 238, 98 S.Ct. 1778, 56 L.Ed.2d 251. That case involved an orthodontist who, having no prior business connection with three food vending businesses, bought their stock and acquired their control after the sellers represented that the corporation had sufficient cash to pay its accrued liability for withheld employee wage and Federal Insurance Contribution Act (FICA) taxes, which amounted to $250,000. As soon as the orthodontist took command, he found that the representations were untrue; the corporations had no liquid assets. After reporting these findings to the Internal Revenue Service (IRS), he used his personal funds to finance corporate operations and paid all the taxes that later became due.

The initial question presented was whether the orthodontist was a "responsible person." As a postulate for resolving it, the Court stated that there is no question that the statute applies "[w]hen the same individual or individuals who caused the delinquency in any tax quarter are also the 'responsible persons' at the time the Government's efforts to

collect from the employer have failed . . .". 436 U.S. at 245, 98 S.Ct. at 1784, 56 L.Ed.2d at 260-61.

The taxpayer's first argument was that, because the statute uses the conjunctive "and," it reaches only persons who have all three duties: " 'to collect, truthfully account for *and* pay over any tax imposed by this title'." (Emphasis supplied). This, the court concluded, was a misreading: a person is responsible if he has a duty to perform any one of these functions - collecting, accounting or paying over; the penalty is not limited "to those persons in a position to perform all three of the enumerated duties with respect to the tax dollars in question." 436 U.S. at 250, 98 S.Ct. at 1787, 56 L.Ed.2d at 263. The orthodontist was in authority when the corporation had a duty to pay over the taxes due; he might therefore be considered a "responsible person" if he himself had a duty at that time to apply available funds to payment of the taxes.

The Court next considered the scope of liability of an individual becoming a responsible person for the first time after withholding tax liability has accrued and the trust funds have been dissipated. It held that funds collected by the corporation after a change in corporate control are not impressed with a trust for taxes withheld during a prior regime unless those funds are directly traceable to dissipated trust funds; failure to use such later acquired funds to pay federal withholding taxes does not constitute a violation of the § 6672 requirement that the responsible person "pay over" withholding taxes. See 436 U.S. at 258, 98 S.Ct. at 1791, 56 L. Ed.2d at 269.

The trust § 7501 creates for funds withheld may in most circumstances be enforced. However, the liability of re-

sponsible persons generally is not limited to restoring actual cash diverted from the trust; it encompasses the duty to have initially or to collect funds to pay withholding taxes. Thus, if a corporation has only sufficient cash to pay net wages, and does so, there may literally be no funds to constitute the corpus of the trust, but the responsible persons are nevertheless liable for failure to collect withholding taxes; the United States may not be made an unwilling joint venturer in the corporate enterprise. *Brown v. United States*, 5 Cir. 1979, slip op. 3680,___F.2d___ ; *Sorenson v. United States*, 9 Cir. 1975, 521 F.2d 325; *Pacific National Insurance Co. v. United States*, 9 Cir. 1970, 422 F.2d 26, *cert. denied*, 398 U.S. 937, 90 S.Ct. 1838, 26 L.Ed.2d 269. *See also Frazier v. United States*, 5 Cir. 1962, 304 F.2d 528.

[1] It is in this light that we must read observations in *Slodov* that § 7501 and § 6672 do not "impress a trust on . . . after acquired cash," 436 U.S. at 254, 98 S.Ct. at 1789, 56 L.Ed.2d at 266, or that § 6672 cannot "be construed as establishing a fiduciary obligation to pay over after-acquired cash unrelated to the withholding taxes." 436 U.S. at 255, 98 S.Ct. at 1789, 56 L.Ed.2d at 267. The orthodontist in *Slodov* was not subject to a § 6672 penalty because the funds he acquired after his accession to control were not subject to a trust, and his duty as a person assuming corporate control with respect to the accrued withholding tax liability was limited to paying any trust funds related to that liability and any other funds directly traceable to those trust funds that had been dissipated. Where there has been no change in control, however, responsible persons are subject to a duty to apply any available unencumbered funds to reduction of accrued withholding tax liability, whether or not those funds are deemed to be trust funds within the meaning of § 7501. *See Maggy v. United States*, 9 Cir. 1977, 560 F.

2d 1372, 1376, and *Teel v. United States*, 9 Cir. 1976, 529 F.2d 903, 905. Although both *Maggy* and *Teel* stated that such funds are held in trust, this was unnecessary to the results reached in those cases. Furthermore, although those cases antedate *Slodov*, nothing in those opinions restricts their continued applicability. In fact, *Slodov* implicitly affirms their conclusions because the Court assumes at the outset that a penalty may be exacted from a person who was responsible both during the period withholding tax liability accrued and thereafter. 436 U.S. at 244-45, 98 S.Ct. at 1784, 56 L.Ed.2d at 260-61. The Court also specifically limited its holding to funds acquired after the responsible person's "accession to control." [1] 436 U.S. at 258-59, 98 S.Ct. at 1791, 56 L.Ed.2d at 269.

[2] At no point does *Slodov* reach the need to define the meaning of the term "willfully" with respect to individuals who were responsible persons both before and after withholding tax liability accrued. The term "willfully" is defined by prior cases as meaning, in general, a voluntary, conscious, and intentional act, such as payment of other creditors in preference to the United States, although bad motive or evil intent need not be shown. *Liddon v. United States*, 5 Cir. 1971, 448 F.2d 509, 513, *cert. denied*, 1972, 406 U.S. 918, 92 S.Ct. 1769, 32 L.Ed.2d 117; *Monday v. United States*, 7 Cir. 1970, 421 F.2d 1210, 1216, *cert. denied*, 400 U.S. 821, 91 S.Ct. 38, 27 L.Ed.2d 48; *Hewitt v. United States*, 5 Cir. 1967, 377 F.2d 921, 924. The willfulness requirement is satisfied if the responsible person acts with a reckless disregard of a known or obvious risk that trust funds may not be remitted to the Government, *see Teel v. United States, supra*.

1. We note that the Court's language also does not rule out the possibility that, where there has been no accession to control, funds acquired after withholding tax liability has accrued may be "trust funds" within the meaning of §7501.

and *Monday v. United States, supra,* 421 F.2d at 1215, such as by failing to investigate or to correct mismanagement after being notified that withholding taxes have not been duly remitted. *Kalb v. United States,* 2 Cir. 1974, 505 F.2d 506, 511, *cert. denied,* 1975, 421 U.S. 979, 95 S.Ct. 1981, 44 L. Ed.2d 471; *United States v. Leuschner,* 9 Cir. 1964, 336 F. 2d 246, 248.

[3,4] Although the Fifth Circuit recognizes that reasonable cause may excuse the failure to collect, account for, or pay over withholding taxes, *see Newsome v. United States,* 5 Cir. 1970, 431 F.2d 742, 746, the mere delegation of responsibility to another does not constitute reasonable cause. Moreover, once an assessment of penalty taxes is made and it is established that the taxpayer is a responsible person, the burden of proving lack of willfulness is on the taxpayer. *E.g., Anderson v. United States,* 8 Cir. 1977, 561 F.2d 162, 165; *Liddon v. United States, supra,* 448 F.2d at 513-14.

II.

Each of the appellants, save Moore, was an officer, director and stockholder of Savannah, a business corporation, at the time its employees' income and FICA taxes should have been withheld and paid. At the same time, Moore was Savannah's general manager and handled day-to-day operations. A Mr. Lavoie was employed as controller and prepared corporate checks, but he had no authority to sign or countersign those checks. Two signatures were required for checks drawn on the regular corporate account; this meant that the signatures of two directors or of Moore plus one director were requisite. The corporation also had a payroll and salvage account. Only one signature was necessary for checks drawn on that account, and Moore was usually the signatory.

During the first three quarters of 1969, ending September 30, income and FICA taxes were withheld when the corporate employees were paid, but the portion retained by Savannah was not paid to the government although, under the statute, it was "held in trust" for that purpose. On October 6, at the instance of an IRS agent, a meeting was held to discuss this liability. Each of the officers was present. Moore admits he knew of the arrearages in August but each of the other officers contends that before the meeting he knew nothing of them. Lavoie, they assert, prepared all payroll checks and presented them for signature (although Lavoie had no authority to sign or countersign any check). Each assumed that Lavoie was paying over the withheld taxes. Following the October 6 meeting, Savannah paid the amount due for the first quarter of 1969, leaving unpaid the debts for the second quarter ($49,386.04) and third quarter ($29,333.67). The total of these sums is $78,719.71. On November 7, Moore was discharged. Savannah continued to operate until February 1970, when the holder of the first mortgage on its property foreclosed. It is now a dormant shell, fiscally, though not legally, bankrupt. From October 6 through the end of that month, there were total deposits to Savannah's checking account of about $96,000, but none of these funds was applied to the tax debts. During the period after October 6, each of the appellants except Sadler signed one or more corporate checks drawn to creditors for substantial amounts.

In May 1974, the IRS assessed $78,719.71 against some of the officers as penalties under § 6672. They paid $100 each toward the assessment and sued for refunds. The government counterclaimed for the balance owed and joined the remaining defendants. The material facts apparently being undisputed, the case was submitted on cross-motions for summary

judgment, and the trial court granted the government's motion.

III.

Each of the individuals assessed now asserts that summary judgment was inappropriate because there were disputed issues of material fact: their willfulness and their control over Savannah. Rule 56(c), F.R.Civ.P. With respect to disputed facts we must, of course, assume the version most favorable to the officers. *See United States v. Diebold, Inc.*, 1962, 369 U.S., 654, 82 S.Ct. 993, 8 L.Ed.2d 176; *Poller v. Columbia Broadcasting System, Inc.*, 1962, 368 U.S. 464, 82 S. Ct., 486, 7 L.Ed.2d 458; *BAW Manufacturing Co. v. Slaks Fifth Avenue, Ltd.*, 5 Cir. 1977, 547 F.2d 928, 930. Therefore we must credit that, except for Moore, the individuals assessed had no knowledge before the October 6 meeting that any taxes were in arrears and that Moore knew of the default in August, but was informed that Lavoie would take care of it. We assume also that, although the directors together had complete control over corporate affairs, they did not exercise their prerogatives, leaving management to Moore.

If it is assumed that prior to the October 6 meeting the officers were unaware that the taxes had not been paid, there is no dispute as to any material fact, unless that very lack of knowledge would relieve them of liability. However, the legal effect of that fact as material or immaterial is properly resoluble on motion for summary judgment. *See, e. g., Ralli-Coney, Inc. v. Gates*, 5 Cir. 1976, 528 F.2d 572, 574.

IV.

[5] The trial court did not attempt to determine whether

the officers assessed were responsible persons before October 6. It found that from that date, when they acquired actual knowledge of the tax liability, they were responsible. However, as we have indicated, responsibility is a matter of status, duty and authority, not knowledge. On October 6 no one's status, duty or authority changed. The statute as construed in *Slodov, supra,* makes it clear that each of appellants was a responsible person before as well as after October 6. The officers, directors and the general manager of the corporation were in complete control of its affairs. Their authority to see that trust funds were remitted made them "responsible persons" under § 6672. *Liddon v. United States, supra,* 448 F. 2d at 512; *Brown v. United States,* 5 Cir. 1972, 464 F.2d 590, *cert. denied,* 1973, 410 U.S. 908, 93 S.Ct. 962, 35 L. Ed.2d 270; *Hewitt v. United States, supra; Anderson v. United States, supra; Monday v. United States, supra.*

While Moore did not have the same authority as the officer-directors, he had greater management responsibilities. He could have refrained from signing checks on the payroll and salvage account to other creditors until the United States was paid. He also had authority over the controller, Lavoie, on whom all of the appellants place blame.

The conclusion that the appellants were responsible persons is supported by our prior decision in *Liddon v. United States, supra;* we there held that evidence that a director was the only person at the company's home office who was permitted to sign checks supported a finding that he was a responsible person, even though the right-hand man did most of the check signing and supervised the clerical operations of the company.

The real issue here is whether the officers assessed acted

willfully in failing to discharge their duty after October 6, With respect to the question of willfulness, the trial court found it undisputed that after October 6 each officer save Sadler signed one or more checks paying private creditors in preference to the government, and that Sadler actually knew the taxes were unpaid, and yet took no action. Moreover, the court found it undisputed that there were monies avilable after October 6 with which to restore the trust funds.[2] On this basis, the court concluded that the officers' failure to attend personally to discharge of the corporate liability must be considered willful.

The issue of willfulness is necessarily directed to the state of the responsible person's mind, a subjective determination. This determination is usually factual, and "if sufficiently controverted, would preclude the granting of a summary judgment on penalty liability," *Teel v. United States, supra,* 529 F.2d at 905. However, as the court held in *Teel, supra,* evidence that the responsible person had knowledge of payments to other creditors after he was aware of the failure to pay withholding tax is sufficient for summary judgment on the question of willfulness. *See also Kalb v. United States, supra,* 505 F.2d at 511, and our decision in *Moore v. United States*, 5 Cir. 1972, 465 F.2d 514, 516, *cert. denied*, 1973, 409 U.S. 1108, 93 S.Ct. 907, 34 L.Ed.2d 688, sustaining the correctness of a charge to the jury that the taxpayer's conduct was willful as a matter of law.

In essence the appellants' primary argument is that an

2. On October 6, the corporation had on hand about $34,000. Subsequently during the month of October, and prior to Moore's dismissal on November 1, the corporation deposited approximately $58,000 in its general account. The taxpayers neither alleged nor offered any evidence that these funds were encumbered or otherwise restricted so that they were unavailable for payment of withholding taxes.

issue was created with respect to willfulness by their contention that Lavoie, the controller, misled them by asserting that he had taken care of the matter or would take care of the matter for them. However, once they were aware of the liability to the government, they were under a duty to ensure that the taxes were paid before any payments were made to other creditors. If, after receiving actual notice, corporate officials could once again delegate their responsibility to subordinates, then repeated escape from liability would be possible and the government would be required to monitor corporate affairs daily. The statutory concept of willfulness conveys no such meaning.

The appellants also contend that *Slodov* holds that responsible persons are not subject to a duty to use after-acquired funds to pay withholding taxes, and that, therefore, their actions were not "willful" because the only funds available to pay withholding taxes after they became aware of Savannah's withholding liability were funds acquired after that obligation became payable. However, as our discussion of *Slodov* indicates, their argument is based on a misreading of that decision; its holding regarding liability for failure to apply after-acquired funds to withholding taxes is limited to the situation of an individual becoming a responsible person after those taxes are payable and trust funds have been dissipated. In the case of individuals who are responsible persons both before and after withholding tax liability accrues, as the appellants were in this case, there is a duty to use unencumbered funds acquired after the withholding obligation becomes payable to satisfy that obligation; failure to do so when there is knowledge of the liability, as was the case here, constitutes willfulness.

In conclusion, there can be no serious dispute concerning

the correctness of the court's conclusion that each of the officers was a person who had ultimate authority over the corporate expenditures, could have seen to it that the taxes were paid, and who can fairly be said to have acted purposely, that is to say, willfully, in devoting available corporate funds to purposes other than payment of withholding taxes.

Because the officers assessed are jointly and severally liable for the penalty provided in § 6672, *see Brown v. United States*, 5 Cir. 1979, slip op. 3680, F.2d , it is not necessary to apportion liability in this case. In addition, because the government has stated that its policy is to collect only 100 percent of the employer's deficiency, it is unnecessary to decide whether the government may collect the full § 6672 penalty from both Brown and Sibley; nevertheless, we note that it is doubtful whether the government may obtain more than one satisfaction of Savannah's withholding liability, which underlies the liability of the appellants. *Id.*

For the foregoing reasons, the judgment of the district court is AFFIRMED.

A true copy
Test: EDWARD W. WADSWORTH
Clerk, U.S. Court of Appeals, Fifth Circuit

By s/ Brenda Hauck
Deputy
May 15, 1979
New Orleans, Louisiana

JUDGMENT

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

NO. 77-2104

D.C. Docket No. CA474-243, 474-244, 474-245 and 474-246

IRWIN MAZO, MARVIN I. ROSENZWEIG, ERWIN A. FRIEDMAN and BARNEY L. SADLER,
Plaintiffs,

versus

UNITED STATES OF AMERICA,
Defendant-Appellee,

versus

MARVIN I. ROSENZWEIG, ERWIN A. FRIEDMAN, BARNEY L. SADLER, WILLIAM LATTIMORE, NORMAN W. FRIES, GEORGE MOORE, and IRWIN MAZO,
Defendants-Appellants.

Appeal from the United States District Court for the Southern District of Georgia

Before GEWIN, GEE and RUBIN, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the South-

ern District of Georgia, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed;

It is further ordered that defendants-appellants pay to defendant-appellee, the costs on appeal to be taxed by the Clerk of this Court.

March 23, 1979

ISSUED AS MANDATE: May 15, 1979

A TRUE COPY
Test: EDWARD W. WADSWORTH
Clerk, U. S. Court of Appeals, Fifth Circuit

By: s/ Brenda Hauck
Deputy
May 15, 1979
New Orleans, Louisiana

APPENDIX B

Internal Revenue Code of 1954 (26 U.S.C.):

SEC 3102. DEDUCTION OF TAX FROM WAGES.

(a) *Requirement.* – The tax imposed by section 3101 shall be collected by the employer of a taxpayer, by deducting the amount of the tax from the wages as and when paid.***

SEC 3402. INCOME TAX COLLECTED AT SOURCE.

(a) *Requirement of Withholding.* – Every employer making payment of wages shall deduct and withhold upon such wages (except as otherwise provided in this section) a tax determined in accordance with the following tables.***

SEC 6671. RULES FOR APPLICATION OF ASSESSABLE PENALTIES.

(a) *Penalty Assessed as Tax.* – The penalties and liabilities provided by this subchapter shall be paid upon notice and demand by the Secretary or his delegate, and shall be assessed and collected in the same manner as taxes. Except as otherwise provided, any reference in this title to "tax" imposed by this title shall be deemed also to refer to the penalties and liabilities provided by this subchapter.

(b) *Person Defined.* – The term "person" as used in this subchapter, includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

SEC. 6672. FAILURE TO COLLECT AND PAY OVER TAX, OR ATTEMPT TO EVADE OR DEFEAT TAX.

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable.

Federal Rules of Civil Procedure

Rule 56. SUMMARY JUDGMENT

(c) *Motion and Proceedings Thereon.* The motion shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

Supreme Court, U. S.
FILED
AUG 16 1979
MICHAEL RODAK, JR., CLERK

No. 78-1891

In the Supreme Court of the United States

OCTOBER TERM, 1978

WILLIAM LATTIMORE, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

WADE H. MCCREE, JR.
Solicitor General
Department of Justice
Washington, D.C. 20530

In the Supreme Court of the United States

OCTOBER TERM, 1978

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WILLIAM LATTIMORE, ET AL., PETITIONERS

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UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The question presented in this federal tax case is whether the decision below correctly imposed personal liability upon petitioners under 26 U.S.C. 6672, for their failure to collect, account for, or pay over taxes required to be withheld from the wages of their corporation's employees.

The pertinent facts may be summarized as follows: Petitioners were directors, officers, or stockholders of Savannah Inn and Country Club, Inc., a corporation that acquired and operated a hotel property (Pet. App. A-6 to A-8). The corporation failed to pay over income and FICA taxes withheld from its employees in the amount of $78,619.71 during the second and third quarters of 1969 (Pet. App. A-2). Petitioners were unaware that the taxes had not been paid until October 6, 1969. At that time,

they were so informed at a meeting with representatives of the Internal Revenue Service (Pet. App. A-11). However, petitioners were in complete control of the corporation's affairs both before and after October 6, 1969 (Pet. App. A-33).

After they became aware of the corporation's tax deficiencies, each of petitioners used corporate funds to pay and prefer creditors other than the United States. During the second and third quarters of 1969, the corporation maintained bank balances and had sufficient funds on deposit to pay the withholding taxes. During October 1969, a total of $98,869.69 was deposited in the corporation's checking account (Pet. App. A-18).

On these facts, the district court held that petitioners, as responsible officers of the corporation, had a duty to use the corporate funds available after they became aware of the tax deficiencies on October 6, 1969, to pay the tax arrearages, and that their knowing failure to do so was willful failure to pay over such taxes within the meaning of 26 U.S.C. 6672. Accordingly, it held them jointly and severally liable for the taxes under that provision (Pet. App. A-20 to A-21). The court of appeals affirmed (Pet. App. A-22 to A-36).

1. The decision below correctly held that petitioners were personally liable for the unpaid withholding taxes of their corporation.

Sections 3102(a) and 3402(a) and (d) of the Internal Revenue Code of 1954 require every employer to withhold federal income and social security taxes from the wages of his employees. Section 7501 provides that the withheld funds constitute a special trust fund in favor of the United States. If an employer withholds a tax but fails to pay it over to the United States, the employee is nevertheless

credited with having paid the tax and the government will not require any additional payment from the employee. Thus, unless the government has recourse against the person responsible for the collection and payment of the tax, the revenues would be put in jeopardy.

Section 6672 of the Code gives the government recourse against the responsible person. It imposes personal liability upon "[a]ny person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof * * *." The thrust of the statute is to impose personal liability upon those persons whose conduct results in the failure to pay withheld taxes. In the typical case, as here, the statute is used as a collection device against officers of a bankrupt corporation for the taxes withheld from its employees' wages.

Petitioners contend (Pet. 7-10) that their lack of knowledge of the corporation's tax deficiencies prior to October 6, 1969, absolves them from personal liability under this Court's decision in *Slodov* v. *United States*, 436 U.S. 238 (1978).

But the court of appeals correctly concluded that *Slodov* does not speak to the facts of this case. In *Slodov*, the Court held that a responsible officer was not liable for taxes withheld and dissipated prior to his assumption of control of a corporation because neither Section 6672 nor Section 7501 impresses a trust on the after-acquired funds of the corporation absent tracing of those funds to the taxes collected. Since the previous management had failed to pay over the taxes when due and had used the withheld taxes for other purposes, the Court refused to impose

Section 6672 liability upon the innocent successor officer for failure to use after-acquired funds to discharge the tax liability.

Here, by contrast, there was no change in management. Petitioners were responsible officers both before and after October 6, 1969, the date upon which they became aware of the tax deficiencies. Hence, unlike *Slodov*, there was no prior set of officers who dissipated the trust fund of taxes so that any after-acquired funds would not be impressed with a Section 7501 trust. As the court of appeals concluded, *Slodov* does not alter the rule that where there has been no change of control, responsible persons are subject to a duty to apply any available unencumbered funds to pay withholding tax deficiencies, whether or not those funds are deemed to be Section 7501 trust funds. See *Maggy* v. *United States*, 560 F. 2d 1372, 1376 (9th Cir. 1977), cert. denied, No. 77-1542 (Oct. 2, 1978); *Teel* v. *United States*, 529 F. 2d 903, 905 (9th Cir. 1976). Petitioners accordingly err in their contention that their discovery of the tax deficiencies on October 6, 1969, constituted a "change in control" on that date within the meaning of *Slodov*. Indeed, since the decision below, two other circuits have rejected such a construction of this Court's opinion in *Slodov*. See *Kizzier* v. *United States*, 79-1 USTC (CCH) para. 9373 (8th Cir. May 15, 1979); *Garsky* v. *United States*, 79-2 USTC (CCH) para. 9436 (7th Cir. June 14, 1979). In sum, since petitioners were responsible officers both before and after October 6, 1969, they must answer for their conduct throughout the entire period.

2. Petitioners also argue (Pet. 10-11) that the district court erred in granting summary judgment for the government because an issue of fact existed as to their willfulness prior to October 6, 1969, in causing the delinquency. But petitioners' state of knowledge prior to October 6, 1969, was irrelevant. The critical evidence of willfulness that triggered their liability was their failure after October 6, to use corporate funds then available to pay the tax deficiencies of which they were concededly aware. The district court's grant of summary judgment was entirely proper.[1]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
Solicitor General

AUGUST 1979

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[1]It is well settled that there may be more than one responsible person at a given time and that two or more such persons may be held jointly and severally liable under Section 6672. See *Monday* v. *United States*, 421 F. 2d 1210 (7th Cir. 1970); *Kalb* v. *United States*, 505 F. 2d 506 (2d Cir. 1974). Petitioners therefore err in arguing (Pet. 11) that the courts below failed to recognize an issue of fact as to which of the seven petitioners were responsible and willful after October 6, 1969.